

ORIGINAL

OPEN MEETING AGENDA ITEM



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Arizona Corporation Commission

DOCKETED
MAY 30 2013

DOCKETED BY [Signature]

IN THE MATTER OF THE APPLICATION
OF PIMA UTILITY COMPANY, AN
ARIZONA CORPORATION, FOR A
DETERMINATION OF THE FAIR VALUE
OF ITS UTILITY PLANTS AND
PROPERTY AND FOR INCREASES IN ITS
WATER RATES AND CHARGES FOR
UTILITY SERVICE BASED THEREON.

DOCKET NO. W-02199A-11-0329

IN THE MATTER OF THE APPLICATION
OF PIMA UTILITY COMPANY, AN
ARIZONA CORPORATION, FOR A
DETERMINATION OF THE FAIR VALUE
OF ITS UTILITY PLANTS AND
PROPERTY AND FOR INCREASES IN ITS
WASTEWATER RATES AND CHARGES
FOR UTILITY SERVICE BASED
THEREON.

DOCKET NO. SW-02199A-11-0330

**PIMA UTILITY COMPANY'S
COMMENTS TO STAFF REPORT
AND RECOMMENDED ORDER**

Pima Utility Company ("Pima" or the "Company") or the "Company") responds to
Staff's Report and Recommended Order filed on May 1, 2013.

BRIEF INTRODUCTION

The Commission recently issued Decision No. 73573 (November 12, 2012)
establishing Pima's current rates for water and wastewater utility service. In addition to
setting the Company's rates, that decision authorized Pima to seek recovery of income tax
expense should the Commission change its policy for treatment of income tax expense for
pass-through tax entities.¹ On February 21, 2013, the Commission issued Decision No.
73739 authorizing pass-through entities, like Pima, to seek to recover income taxes as part

¹ Decision No. 73573 at 29:9-12.

1 of the cost of service. The Company's Petition to Amend Decision 73573 Pursuant to
2 A.R.S. §40-252 ("Petition") followed on March 29, 2013.

3 In the Petition, Pima seeks further adjustment to its rates and charges in order to
4 allow it to recover income tax expense in its cost of service. On May 1, 2013, Staff issued
5 a Staff Report and proposed form of order recommending approval of the rate increase
6 and associated rate design filed by the Company. There is no dispute over the rates or rate
7 design. However, Pima takes Exception to two separate aspects of Staff's comments and
8 recommendations. First, Pima does not believe it should be ordered to file a full rate case
9 application for both its water and wastewater divisions by no later than June 30, 2015,
10 using a 2014 calendar test year. Second, Staff's discussion of whether the income tax
11 recovery is an imputed expense or an allowance is more than just confusing; this
12 discussion is unnecessary and creates the risk of misunderstandings in future Commission
13 proceedings.

14 Accordingly, Pima asks that the Commission (1) postpone the requirement to file
15 another rate case; and (2) make clear that income tax recovery is an imputed expense.²

16 **EXCEPTIONS TO STAFF RECOMMENDATIONS**

17 **A. Staff's Recommendation for a Follow-Up Rate Case Should be** 18 **Modified**

19 Staff recommends that the Company be required to file another rate case by
20 June 30, 2015.³ Staff does not state any reason for this recommendation or provide any
21 explanation except to state that it will put four years between rate case test years.⁴

22 ² For the Commission's convenience, the Company has included proposed amendments to Staff's
23 Recommended Order with this filing. See **Exhibit A**.

24 ³ Staff Report at 2.

25 ⁴ Compare April 26, 2013 Staff Report in *Johnson Utilities*, Docket No. WS-02987A-08-0180, in which
26 Staff states that a similar recommendation is being made "because of the length of time between rate cases
that would occur if the Company did not file a new rate case application for several years." That utility's
current rates are based on a 2007 test year, which is well before this rate case for Pima, eliminating any
need for the two utilities to be treated in an identical manner.

1 While mathematically correct, this is not a basis to force Pima to prematurely file its next
2 rate case. Nor would it be in the public interest to do so. As the record in Phase 1 of this
3 docket reflects, the Company recently took out a five-year loan that will have to be
4 replaced at the end of its term. That refinancing will drive the timing of the next rate case
5 ensuring that it is filed no later than June 30, 2017.⁵ A rate filing will inevitably occur at
6 that time even if another rate case takes place in the intervening years. Therefore, Staff's
7 recommendation, if adopted, will ensure that the Company and its customers go through
8 two rate cases in roughly four years, burdening the customers with the cost of both
9 proceedings and the parties with the burden of administration. Pima suggests that the
10 Commission modify Staff's recommendation such that Pima be required to file a rate case
11 by no later than June 30, 2017, based on a test year ending December 31, 2016. Adoption
12 of this alternative would eliminate the unnecessary and detrimental impacts of Staff's
13 recommendation.

14 **B. Recovery of Income Taxes is an Imputed Expense**

15 The Staff Report contains a section entitled "Terminology" in which Staff
16 discusses the difference between treating income tax recovery as an imputed expense or
17 an allowance.⁶ Unfortunately, while Staff obviously was attempting to clarify a point for
18 the Commission, the result is unnecessary confusion. In the policy statement adopted in
19 Decision 73739, the Commission is very clear, stating that "we hereby adopt a new policy
20 which allows *imputed income tax expense in the cost of service* for limited liability
21 companies, Subchapter S corporations and partnerships."⁷ This is entirely consistent with
22 the 2005 Policy Statement on Income Tax Allowance issued by the Federal Energy
23

24 ⁵ See Rejoinder Testimony of Thomas J. Bourassa – Rate Base, Income Statement and Rate Design at
17:14-19.

25 ⁶ Staff Report at 2.

26 ⁷ Decision 73739, Attachment 1 (Policy Statement on Income Tax Expense for Tax Pass-Through Entities)
at 2 (emphasis supplied).

1 Regulatory Commission (“FERC”). In that case, the FERC specifically recognized it
2 would be impractical to adjusting the rate of return to “equalize” the pre-tax and after-tax
3 returns of a utility.⁸ Accordingly, FERC recognized income tax expense as a part of the
4 cost of service, i.e., an imputed expense.⁹

5 Staff recognizes that the Commission’s policy statement is consistent with the
6 language used by the FERC.¹⁰ Moreover, the Commission’s policy statement and the
7 procedures for determining the income tax expense allowance set forth therein are entirely
8 consistent with the cost of service treatment of income taxes. It follows that no impact on
9 the fair value rate of return needs to be inferred and there is no reason to split hairs over
10 the terminology used in the policy statement or to engage in an analysis of the impact of
11 imputed income tax expense on FVROR, as Staff has sought to do in this case. Instead,
12 the Commission need only classify the recovery of income taxes as an imputed expense.

13 CONCLUSION

14 This Phase of this rate case is straightforward. The Commission has changed its
15 policy on recovery of income taxes as a cost of service by pass-through entities.
16 The Commission contemplated this possibility in its decision last November for Pima and
17 now the Company’s rates need to be set consistent with Commission policy.
18 The Commission can do this by approving the rates supported by Staff and Pima, which
19 rates expressly include an amount of imputed income tax expense. There is no reason to
20 burden the Company, the customers or this Commission with another rate case as soon as
21 recommended by Staff.

22
23
24 ⁸ FERC Policy Statement on Income Tax Allowances, Docket No. PL05-5-000 (May 4, 2005), ¶ 40.

25 ⁹ *Id.* See also Rebuttal Testimony of Marc L. Spitzer (filed April 27, 2012 in Docket No. W-02199A-11-
0329, *et al.*) at 3.


26 ¹⁰ Staff Report at p. 2.

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RESPECTFULLY SUBMITTED this 30th day of May, 2013.

FENNEMORE CRAIG, P.C.

By


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ORIGINAL and thirteen (13) copies
of the foregoing were filed
this 30th day of May, 2013 to:

Docket Control
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Phoenix, AZ 85007

COPY of the foregoing hand-delivered
this 30th day of May, 2013 to:

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Exhibit A

COMPANY PROPOSED AMENDMENT # 1

DATE PREPARED: May 30, 2013

COMPANY: Pima Utility Company

DOCKET NO.: W-20199A-11-0329 & SW-02199A-0330

OPEN MEETING DATES: June 11-12, 2013 AGENDA ITEM: U-

Page 5, line 25,

AFTER the word "adopted" INSERT "except as noted herein."

Page 6, line 2,

DELETE the words "through 19" and INSERT the words "and 18."

Page 6,

INSERT the following ordering paragraph: "IT IS FURTHER ORDERED that the Company file a full rate case for both its water and wastewater divisions by no later than June 30, 2017, using a 2016 calendar year test year."

COMPANY PROPOSED AMENDMENT # 2

DATE PREPARED: May 30, 2013

COMPANY: Pima Utility Company

DOCKET NO.: W-20199A-11-0329 & SW-02199A-0330

OPEN MEETING DATES: June 11-12, 2013 AGENDA ITEM: U-

Page 4, Paragraph 14,

DELETE and REPLACE with the "For ratemaking purposes, the Commission will classify this adjustment as an imputed expense, which would be consistent with the intent of the Commission's policy."

Make all other conforming changes.